DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 01-0313
Sales and Use Tax
For Tax Years 1998 through 2001

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ISSUES

I. Sales and Use Tax—Post Mix and CO2 Equipment

Authority: General Motors Corporation v. Indiana Department of State Revenue, 578 N.E.2d 399 (Indiana Tax Court 1991); 45 IAC 2.2-5-8

Taxpayer protests imposition of use tax on post mix and CO2 equipment.

II. Sales and Use Tax—Shipping Pallets

Authority: IC 6-2.2-4-2; 45 IAC 2.2-5-16

Taxpayer protests imposition of use tax on shipping pallets.

STATEMENT OF FACTS

Taxpayer produces and sells soft drinks. Taxpayer sells syrup and provides fountain-style mixing equipment to its customers, who dispense the soft drinks on a glass-by-glass basis. The Indiana Department of Revenue ("Department") issued proposed use tax assessments on the equipment used to mix the drinks and on shipping pallets used by taxpayer to ship goods to a related company. Taxpayer protests these assessments. Further facts will be provided as necessary.

I. Sales and Use Tax—Post Mix and CO2 Equipment

DISCUSSION

Taxpayer protests the Department's proposed assessment of use tax on 73.11% of taxpayer's purchase of fountain-style soft drink mixing equipment. The equipment is located at the various restaurants where taxpayer's customers fill soft drink orders by the glass. The mixing equipment is essentially an elaborate swizzle stick. The Department issued assessments on the equipment

on the basis that 73.11% of the equipment is capitalized by taxpayer and is supplied to taxpayer's customers at no charge.

The Department based its assessment on 45 IAC 2.2-5-8(a), which states:

> In general, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property are taxable. *[45 IAC 2.2]*extends only to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. It does not apply to material consumed in production or to materials incorporated into tangible personal property produced.

The Department determined that the equipment was not used directly by the purchaser (taxpayer) in the direct production of tangible personal property. Therefore, the exemption afforded by 45 IAC 2.2-5-8 did not apply.

Taxpayer protests that the equipment is used in its continuous production process, and should be exempt from sales tax as described in 45 IAC 2.2-5-8. Taxpayer refers to General Motors Corporation v. Indiana Department of State Revenue, 578 N.E.2d 399 (Indiana Tax Court 1991). In General Motors, the court explains:

> Finally, a determination that an integrated production process ends upon the completion of the actual end product marketed (the most marketable product) is wholly consistent with the legislative purposes of the exemption statutes to encourage industrial growth and to avoid tax pyramiding.

Id. at 405

Taxpayer believes that its most marketable product is the individual glass of soft drink, and that its production process ends with the mixing of ingredients through the mixing equipment at issue. Since, according to taxpayer, the most marketable product is made with the mixing equipment, the production process does not end until the mixing equipment is used, thereby making the equipment part of the production process and exempt as provided in 45 IAC 2.2-5-8.

Taxpayer's position is flawed. Taxpayer's customer is not the ultimate consumer of the soft drink. Rather, taxpayer's customer is the restaurant. The restaurant buys syrup from taxpayer. The customer's employees then use the equipment to mix the syrup with chilled water and CO2. Taxpayer's actual end product marketed to its restaurant customers is the syrup, not the completed soft drink. Therefore, the production process ends when taxpayer sells the syrup to the restaurant.

Taxpayer also asserts that to tax the mixing equipment would result in tax pyramiding. The court in General Motors explained:

> When equipment or materials used in the direct manufacturing process are taxed, the tax is generally passed on as part of the cost of the product being produced.

General Motors at 405.

As previously established, the equipment is not used in the direct manufacturing process by taxpayer. Any processing utilizing the mixing equipment is performed after taxpayer has sold its product (syrup) to its customer. The purchase of the mixing equipment is not part of the manufacturing process of the syrup, which taxpayer sells to its customers.

While taxpayer is correct that the final consumers of soft drinks want a pre-mixed drink, taxpayer does not charge by the glass, but rather charges for the syrup. The mixing equipment is not part of taxpayer's production process. Therefore, the mixing equipment is not directly used by the purchaser in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property, and is not eligible for the exemption provided in 45 IAC 2.2-5-8. The equipment is not used by taxpayer, and does not play any role in the manufacture of syrup. It is the syrup which is taxpayer's actual end product marketed to its restaurant customers, so no tax pyramiding occurs.

FINDING

Taxpayer's protest is denied.

II. Sales and Use Tax—Shipping Pallets

DISCUSSION

Taxpayer protests the imposition of use tax on shipping containers used to ship goods to an out of state sister division. The Department assessed taxpayer's purchase of the containers. The Department referred to 45 IAC 2.2-5-16, which states in part:

> (a) The state gross retail tax shall not apply to sales of nonreturnable wrapping materials and empty containers to be used by the purchaser as enclosures or containers for selling contents to be added, and returnable containers containing contents sold in a sale constituting selling at retail and returnable containers sold empty for refilling.

Taxpayer protests that the containers are used for selling finished goods to its sister division, which does not return the pallets to taxpayer, thus constituting a retail transaction.

Also of relevance is IC 6-2.2-4-2, which states in pertinent part:

> (a) A person is a retail merchant making a retail transaction when he is making wholesale sales.
> (b) For purposes of this section, a person is making wholesale sales when he:
> (1) sells tangible personal property, other than capital assets or depreciable property, to a person who purchases the property for the purpose of reselling it without changing its form;

Taxpayer has provided sufficient documentation to establish that the containers are nonreturnable and are used by the purchaser as a container for selling contents to be added. In this case the finished goods are added to the containers and then the finished goods are sold in a retail transaction without return of the pallets. Also, while taxpayer does purchase and capitalize some pallets used in its business, the pallets resold to the sister corporation are expensed rather than capitalized. Therefore, taxpayer is making a retail transaction under IC 6-2.2-4-2 and so satisfies the exemption requirements of 45 IAC 2.2-5-16.

FINDING

Taxpayer's protest is sustained. The pallets and containers expensed and used by taxpayer to ship goods to its out of state sister division are exempt.

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